Nova Scotia Liquor Corporation
Internal Control Review
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Grant Thornton

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Introduction

The Nova Scotia Liquor Corporation (NSLC) purchases inventory for resale, services and supplies, as well as capital assets. While each department is responsible for determining the types of purchases required, all purchasing is processed through the Purchasing and Distribution department. Within the Purchasing and Distribution department, the Buyers are responsible for purchasing inventory for resale and the Supervisor – Sundry Purchases and Tendering is responsible for all other purchases.

Inventory For Resale

The NSLC's core inventory consists of approximately 2,000 brands of beer, wine, coolers and spirits that are either purchased domestically or imported from other countries. The Merchandising and Marketing department is responsible for developing and maintaining the inventory list. The department is also responsible for fostering vendor relationships, ensuring vendors properly complete new listing and price change applications, and communicating new listings and special promotions to buyers. The listing process is governed by the listing committee whose mandate is to ensure the listing policy and procedures are applied to all vendor applications.

All liquor purchases are selected from the inventory list by one of the three Buyers (Domestic, Import or Special Markets). The Buyers are responsible for monitoring and managing the level of warehouse inventory to sustain the targeted level of inventory turnover while minimizing stock outs. Inventory is tracked both at the warehouse and store levels. The cost of inventory on hand over the past two fiscal years averages $23 million, consisting of $11 million in the warehouse and $12 million in the stores. Inventory purchases in fiscal 2003 were approximately $210 million (2002 - $201 million).

The Warehouse department is responsible for receiving, stocking, and shipping the inventory as appropriate. The Warehouse department staff are also responsible for forwarding customs

documents to the Purchasing and Distribution department for processing and for preparing excise documents as required by the Customs Tariff Act and the Excise Act.

Other Purchases

As noted above, the Supervisor – Sundry Purchases and Tendering is responsible for all purchases other than those of inventory for resale. This individual is responsible for ensuring that the purchase of goods, services, and construction work complies with the Purchasing Manual that incorporates the Province of Nova Scotia Policy on Government Procurement and the Atlantic Procurement Agreement. This ensures that public tenders are issued for purchases over the thresholds specified in the Manual and that invitational tenders or receiving quotes are issued for all other purchases as required by the Manual.

All purchases were made from the NSLC's 3,000 suppliers. During the period from February 1, 2001 to August 27, 2003 approximately $767 million was paid out to these suppliers. The top ten suppliers during that period are as follows:

Rank	Supplier Name	Description of goods and/or services purchased	Total purchases between Feb 1, 2001 and Aug 27, 2003
1	Oland Breweries Limited	Beer	$239,072,000
2	Receiver General	Source deductions	$141,749,000
3	Royal Bank of Canada	Interest and service fees	$45,468,000
4	Moosehead Breweries	Beer	$39,063,000
5	Diageo Canada Inc.	Spirits	$37,529,000
6	Canada Customs	Custom fees and tariffs	$20,358,000
7	Resource Recovery Fund	Recycling deposits	$20,153,000
8	Molson Canada	Beer	$12,710,000
9	Andres Wines Atlantic Ltd.	Wine	$12,028,000
10	Jack Webb Management	Shipping services	$9,222,000
		Total	**$577,352,000**

The total paid to these suppliers represents 75% of expenditures to all suppliers during the stated time period.

Information Technology

The Information Technology department and its management is responsible for the following IT functions within the NSLC's environment:

- Business / IT Solution Strategic Planning
- Project Management (Organizational Change)
- Enterprise Architecture
- Application Support
- IT Support Services
- IT Technical Operations

The Information Technology (IT) department is led by the Director - Information Technology, a new position which was implemented as of August 1, 2003. Prior to August 1, 2003, the IT department was led by Vice President - Finance and IT.

The critical underlying system of the Purchases, Payables and Payments and Inventory Management business processes is the Magstar product management application system (Magstar). The Magstar system provides General Ledger, Accounts Payable, Accounts Receivable, Purchase Order and Inventory / Warehouse modules. The system was implemented in April, 2002 and resides on an Alpha 4100 server with the Tru64 Unix operating system.

Nature and Scope of Review

We have performed an internal control review of the Purchases, Payables, and Payment and Inventory Management systems, including significant underlying Information Technology (IT) infrastructure. The review was performed to assess the design of the internal controls implemented and operated by management. The review was not designed to allow us to express an opinion on the controls, but rather to provide the summarized and detailed results of our review (Appendix A and B).

In the context of an internal control review, scope refers to the extent of work performed and reported upon. It establishes the systems, processes, departments or other elements of an organization that were subject to the review. Typically, the reviewer will establish the scope of the review before performing the engagement.

Business Processes

The scope included review of the following processes within the Purchases, Payables and Payments and Inventory Management systems, including significant underlying Information Technology (IT) infrastructure:

- identifying need for inventory, goods, services and construction
- procuring the identified items (including tendering)
- receiving the items
- recording the transactions in the general ledger
- paying vendors
- safeguarding of physical assets
- assigning employee authority levels and system access
- monitoring general ledger accounts
- monitoring of key performance indicators
- supporting IT policies and procedures governing the confidentiality, integrity and availability of the Magstar environment

Summary of Key Risks Inherent to Processes

The management of the Nova Scotia Liquor Corporation is responsible for implementing controls that mitigate the following significant risks present in the business and processes.

Operational risk due to:

- potential loss due to inefficiencies in processes
- potential loss due to inadequate safeguarding of physical assets
- potential financial loss due to incorrect pricing

Corporate risk due to:

- potential loss due to fraudulent activities by employees/members
- potential loss due to financial statement misstatement
- potential financial and reputation loss from failing to comply with government and other regulators, as well as internal policies
- potential reputation loss from failing to provide quality, safe products that meet consumer demands

Internal Control Objectives

Based on the above scope of business processes, as well as the inherent operational and corporate risks, the objective of the review was to assess, through observation and inquiry, the design of internal controls in order to assist the Corporation in meeting the following internal control objectives:

- Corporation is seen to be an effective buyer and judicious in use of funds.
- Corporation strives to have its staff employ responsible business practices and to protect the reputation of the corporation.
- All expenditures are duly authorized.
- Adequate management information produced and employed in management of purchasing activities.
- Contracts are negotiated in a manner that favours the corporation and payments are correct.
- The quality of goods and terms of delivery are in accordance with the needs of the organization.
- Access to purchase order and supplier processing function/data is restricted to authorized personnel and segregated from incompatible functions.
- Maximize operational efficiency.

- Assets are properly safeguarded.
- Stores are properly stocked.
- Payments are made correctly and maximizes discounts.
- Funds are safeguarded.
- Financial records are accurate.

Key System Interviews

In order to assess the design of internal control procedures in meeting the above internal control objectives, we held interviews with the following personnel:

- Vice President – Purchasing and Distribution
- Supervisor – Sundry Purchases and Tendering
- Purchasing Assistant
- Supplies and Stationary Storekeeper
- Purchases Services Coordinator
- Buyer / Quality Assurance – Imports
- Buyer / Quality – Domestic
- Assistant Warehouse Manager
- Receiving
- Customs/Traffic Clerk
- Excise Clerk
- Licensee Clerk
- Project Manager – Operations &Development
- Manager – Facilities Operations
- Category Manager – Wines
- Junior Listing Coordinator
- Listings Coordinator
- Vice President – Finance
- Manager - Finance
- General Accounting Supervisor
- Secretary to Vice President Finance
- Accounts Payable Clerks
- Cash Audit Clerk
- Budget & Inventory Coordinator
- Financial Analyst
- Manager – Audit and Security
- Director – Information Technology
- Manager – Information Technology
- Network Administrator
- Database Administrator
- System Administrator

Summary of Issues Noted

During our review, we identified several deficiencies in the design of the Corporation's control environment. A number of deficiencies related to the tendering process, including a lack of documentation and adequate performance of procedures. Key examples noted were insufficient support for the evaluation of tenders, the Tendering Checklist was not used, and contracts were not reviewed and compared to the successful bidder / tender prior to signing.

Management does not formally monitor inventory turnover which is one of the key performance indicators for the Corporation. The movement and safeguarding of inventory is clearly the focus of the NSLC's operations, yet the control environment does not provide appropriate preventive controls over theft, breakage, errors in recording receipts and shipments. Similarly, a lack of detective controls was noted, such as consistent period physical inventory counts.

Text withheld as per Section 17(1) of the FOIPOP Act relating to economic interests and trade secrets. Text will be released following implementation of the recommendation.

We noted that management is in the process of updating its policies and procedures, as well as access rights within Magstar, the Product Management System. These updates are expected to continue over the next year. Despite these updates and the subsequent publication / distribution of these revised purchasing procedures, we found several instances of non-compliance with Purchase Manual procedures.

Conclusion

A successful system of internal controls must be 1) designed effectively to meet specified internal control objectives, and 2) operate effectively on an ongoing basis (i.e. control procedures performed effectively and consistently). Our report has identified a number of internal control design deficiencies that should be addressed / remediated by Management. Once these internal control design "gaps" are corrected and new / revised internal control procedures have been in operation for a reasonable period of time (e.g. all revised controls have been operating for at least 3 months), we recommend that the Board sponsor a review of the operating effectiveness of the improved control environment to ensure that the Purchases, Payables and Payments, and Inventory Management control objectives are being met through the continued operation of the related internal control procedures.

Restrictions and Limitations

This report has been prepared to assist the Board and management of the Nova Scotia Liquor Corporation in discharging their responsibilities with respect to specific activities within the internal control environment of the Corporation. We specifically disclaim any responsibility for losses and damages incurred through the use of this report for a purpose other than as described in the above.

We acknowledge that the Nova Scotia Liquor Corporation is bound by the Freedom of Information and Protection of Privacy Act and agree that the Nova Scotia Liquor Corporation may use its sole discretion in any determination of whether, and if so in what form, this report may be required to be released under this Act.

We reserve the right, but will be under no obligation, to review and/or revise the contents of this report in light of information, which becomes known to us after the date of this report.

SUMMARY OF FINDINGS AND RELATED RISKS

No.	Finding	Specific Risk	Recommendation
1.	**Lack of adequate inventory management** a. Warehouse inventory turnover is not formally reviewed. b. Warehouse inventory counts are not performed quarterly and cycle counts are not performed.	a. Inaccurate reorder quantities for products and ineffective inventory management. b. Inaccurate accounting records (e.g. unrecorded shrink) and ineffective inventory management.	a. Management perform a regular formal review of inventory turnover. b. Management and staff perform quarterly inventory counts and cycle counts.
2.	**Ineffective segregation of incompatible duties** Incompatible duties were noted for job positions within Purchasing and Receiving. Also, Manager – Information Systems holds cheque signing authority, as well as unrestricted access to all corporate systems and related accounting data. Overall, security access levels within the Magstar system are not configured to provide adequate segregation of incompatible duties.	Unauthorized product orders as a result of unauthorized changes to item and vendor master files, misappropriation of corporation assets / inventory. In addition, unauthorized disbursements and subsequent concealment could occur. Overall, inability to support effective segregation of incompatible duties for various job positions within the Corporation.	On an interim basis (prior to reconfiguration of Magstar security levels), perform regular independent reviews on a sample of purchases for reasonableness and appropriate approval. Remove Manager – Information Systems signing authority on cheques. Complete the review of Magstar security access levels and implement revised access privileges to appropriately segregate incompatible duties.

No.	Finding	Specific Risk	Recommendation
3.	**Tendering process deficiencies** a. Complete documentation is not always obtained during the tendering process. b. Tenders may be submitted to the Supervisor – Sundry Purchases and Tendering (and subsequently issued) without receiving approval from the individual who holds appropriate budget authority. c. Contracts prepared from tendering procurement are not independently reviewed, on a consistent basis, in order to ensure the terms agree with the successful bid.	a. Incomplete or inaccurate tendering documents may result in the receipt of bids that do not correspond with NSLCs actual requirements and incorrect decisions may result. b. Inefficiencies and unfavorable vendor relations due to cancelled tenders. c. Errors or omissions of approved contract terms may go undetected.	a. Revise and implement the use of a comprehensive tendering checklist. b. Formal approval of tenders prior to issuance of tender. c. Draft contracts be reviewed and compared to original tender package / successful bid to ensure accuracy and completeness.
4.	**Blind spots in warehouse video surveillance** Security noted that there are blind spots in the video surveillance coverage of the warehouse.	Significant financial losses due to theft or destruction of Corporation assets.	Increase coverage of video surveillance within warehouse.

No.	Finding	Specific Risk	Recommendation
5.	**Out-of-date job descriptions** The process to ensure job descriptions are maintained and current is ineffective, resulting in a number of inaccurate job descriptions.	Potential for an employee to perform unauthorized tasks and / or fewer tasks than is required or authorized for their position.	Review the process for maintaining job descriptions to ensure the process is performed in a timely manner, ensuring that changes to job descriptions are reflected in up-to-date master copies of job descriptions in the Human Resource department.
6.	**Blind purchase orders not used** Magstar cannot generate blind purchase orders; as a result, blind purchase orders are no longer used during the receiving process.	Inaccurate inventory receipts may not be detected in a timely manner.	Re-implementing blind purchase orders through the WMS project. Prior to the completion of the WMS project, implement a two member team for receipt of goods (one counting / one checking count to stated quantity).

No.	Finding	Specific Risk	Recommendation
7.	**Numerical gaps in purchase orders/lack of review of open purchase orders** The Magstar system allows the generation of a purchase order and its subsequent deletion creating gaps in the numerical continuity of purchase orders. Open (outstanding) purchase orders are not reviewed on a regular basis.	Incomplete accounting records and unauthorized purchases may occur due to gaps in the numerical continuity of purchase orders. A lack of a periodic review of open (outstanding) purchase orders can lead to unrecorded vendor accounts payable balances due to errors in receiving.	Request that the Magstar vendor provide a log tracking feature of all purchase orders, including deleted purchase orders. Perform an independent review on the reasons for all "unused" (deleted) purchase orders. Perform a periodic independent review of open (outstanding) purchase orders.
8.	**Lack of independent review of reconciliations and remittances** Bank reconciliations, the reconciliation of the accounts payable subledger to the general ledger control account, the HST remittance and the RRFB remittance are not independently reviewed on a monthly basis.	Omissions or errors may not be detected and corrected within the Corporation's accounting records on a timely basis.	Reconciliations and remittances be independently reviewed monthly.

No.	Finding	Specific Risk	Recommendation
9.	**Lack of vendor master file review** Vendor master file is not reviewed on a periodic basis to ensure that each vendor is required and to ensure that "child" vendors are all linked to "parent" vendors.	Excess vendor management effort (multiple payments / incorrect payment mailing addresses, etc) due the existence of duplicate or redundant vendors.	A periodic review be performed and a resulting list of duplicate and / or redundant vendors be maintained for removal (after two years of inactivity).
10.	**Inadequate IT disaster recovery plan** The IT Disaster Recovery Plan is not current.	Inability to recover systems required to continue critical business operations.	Update the IT Disaster Recovery Plan.
11.	**Lack of formal IT risk assessment process** A formal detailed risk assessment process to identify, evaluate and manage risks relating to IT systems, on an ongoing basis, has not been developed.	Inability to make informed risk based decisions with regard to threats against providing continuous IT services critical to enabling business processes and achieving overall business objectives.	Establish an ongoing detailed IT risk assessment framework, including regular assessment of information risks and mitigation strategies.

No.	Finding	Specific Risk	Recommendation
12.	***Text withheld as per Section 17(1) of the FOIPOP Act relating to economic interests and trade secrets. Text will be released following implementation of the recommendation.***	***Text withheld as per Section 17(1) of the FOIPOP Act relating to economic interests and trade secrets. Text will be released following implementation of the recommendation.***	***Text withheld as per Section 17(1) of the FOIPOP Act relating to economic interests and trade secrets. Text will be released following implementation of the recommendation.***
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Note: Coincident with the need to review other aspects of the NSLC and, in light of the recency of the new corporate governance model, Grant Thornton recommended and subsequently conducted a review of the corporate governance model and an enterprise risk management review.

DETAILED FINDINGS

1. Inventory Management

a. Inventory turnover not reviewed

Through interviews with the Budgeting Coordinator and the Vice President – Purchasing and Distribution, we discovered that inventory turnover has not been formally documented and reviewed since the end of fiscal 2002. The reason provided was that quality information is not available to permit a meaningful evaluation of inventory turnover. While we understand the Buyer's review of inventory inherently includes an informal assessment of inventory turnover, the results of these reviews are not documented to permit management to identify possible issues and take appropriate action.

Inventory turnover has been identified by management as one of the two key performance indicators for the NSLC. Management has established benchmarks and an evaluation process to assist in the monitoring of inventory turnover (Purchase Manual Sections PP-010, IM-010 and IM-060). In the absence of inventory turnover control, the NSLC cannot determine if it is effectively managing its inventory, including the trade off of carrying/order costs to stock out costs. High inventory turnover exposes the Corporation to financial and reputation losses through increased order costs to obtain products faster than usual or stock out costs (resulting in unsatisfied customers). Low inventory turnover exposes the Corporation to similar losses through increased carrying costs (particularly if the warehouse is full), risk of product expiring before selling, and unsatisfied customers as the products available may not be the products consumers wish to purchase.

We recommend that management monitor inventory turnover through a regular formal review of inventory turnover consistent with Purchasing Manual procedures.

b. Inventory counts not performed quarterly and cycle counts not performed

During fiscal 2003, inventory was counted three times (October 2002, February 2003, and March 2003). This does not meet the required quarterly counts as required by Section IM-025 paragraph 4 of the Purchasing Manual. In addition, cycle counts are not performed.

The NSLC is currently using a perpetual inventory system. This means that at any given point in time, the inventory on-hand should equal the inventory in the inventory module of Magstar. Due to instances of breakage, product expiry, theft and errors in recording of receipts and shipment, it is not uncommon for discrepancies between physical inventory on-hand and inventory accounting records (per Magstar), requiring adjustments to the inventory accounting records (Magstar). The cumulative adjustment for the three counts noted above was approximately $246,000 or 1% of the average inventory for the year.

During fiscal 2003, the Corporation approved a tendered proposal for a warehouse management system (WMS) which, when implemented, is expected to further facilitate efficient quarterly inventory counts and cycle counts. We recommend that, in the interim, management and staff perform quarterly inventory counts and cycle counts as outlined in the Purchasing Manual.

2. Segregation of Incompatible Duties

Segregation of incompatible duties is a key control designed to prevent employees from both being able to commit and conceal errors or irregularities in the normal course of their duties. The ideal segregation of duties occurs when different employees:

- initiate transactions
- authorize transactions
- record transactions
- verify transactions
- report assets and transactions, and
- have custody of assets.

Regardless of the degree of supervision, the same employee should never perform the following functions:

- the recording/reporting of assets/transactions and custody of the same assets
- the custody of assets and the authorization of transactions for the same asset
- authorization of transactions and recording/reporting of the same transactions
- finance responsibilities and information systems responsibilities

During our review, we noted instances of staff members being assigned duties related to incompatible functions. We also noted that the Magstar user access limitations are not being utilized to their full potential. Examples of the ineffective segregation of incompatible duties noted were:

1. The Manager – Information Systems has both cheque signing authority and administrative access to the computer system.
2. Employees with access to the purchase order module of Magstar can generate purchase orders and make changes to item and vendor master files as well as receive inventory.
3. Employees with the ability to pick orders for distribution have the ability to record to the warehouse and / or the inventory module.

The lack of appropriate segregation of duties may result in the following (with respect to the noted examples):

1. Unauthorized disbursements. In addition, this level of system access may be used to conceal the unauthorized disbursements.
2. Unauthorized product orders through either intentional or inadvertent changes or additions to master file lists.
3. Misappropriation of corporate assets. For example, these employees have the ability to set aside items in the warehouse to prevent them from being included in the picking process, remove the items from the warehouse, and then record the change inventory as an over shipment or other change.

Currently, users are provided access within Magstar to the modules required to fulfill their job requirements. Within the modules, access is either defined as "full access" or "enquiry / read access" using only two of the ten available access levels. This environment does not permit appropriate segregation of incompatible duties. For example, a user with full access to the inventory module can not only add an inventory item to the master file, but the user can also add a vendor to the master file without completing the corporate listing process, thereby permitting the purchase of an unapproved inventory item. We understand that a designated employee is currently working with the Magstar vendor on a project to better implement the access level limitations within Magstar.

We recommend that, until an effective access level model can be implemented within Magstar, a process be implemented whereby samples of purchase orders are reviewed. This review should

be performed on a regular basis by an employee who does not have the ability to create purchase orders. The sample should be reviewed for reasonableness of purchase and appropriate approval.

Management has indicated that the name of the Manager – Information Systems is going to be removed from the Bank's signature card. We recommend that this planned action be performed in an expedited manner.

We strongly recommend that management place a high priority on the timely completion of the above noted development and implementation of a revised Magstar access level model. Management should ensure new user access levels within Magstar are defined and assigned in a manner which promotes appropriate segregation of incompatible duties, including limiting the ability to modify master files, and accompanied by a review of changes to the master files and access rights by an individual who does not have the ability to modify master files and access rights.

3. Tendering Process

a. Tendering Documentation

We noted examples where complete documentation was not obtained during the tendering process as required by the Purchasing Manual. For example, the Tendering Checklist was not used, the Tender Call Requisition Form was not properly completed and/or approved, and support for the evaluation of bids was insufficient.

The absence of these items provides the opportunity for oversight and incorrect decision making.

We recommend that the NSLC implement the use of a comprehensive tendering checklist. We further recommend that the checklist be revised to cover the full process from the decision to tender to the signing of the contract. The checklist should be placed in the front of the tendering file and the Purchasing Assistant should be responsible for ensuring the checklist is complete.

b. Tendering Approval

Tenders may be submitted to the Supervisor – Sundry Purchases and Tendering (and subsequently issued) without receiving approval from the individual with appropriate budget authority.

The lack of proper approval prior to issuance may result in unfavourable vendor relations. For example, a tender may be issued in error (e.g. without adequate approved budget) and subsequently cancelled, leaving the vendors with no compensation for the time they invested into preparing a proposal.

We recommend the tendering procedures require the department requesting the tender to approve the tender before the tender is issued. Approval of tenders should be evidenced with the signature of an individual with related budget responsibilities and an appropriate authorization limit.

c. Review of contracts terms prior to signing

Contracts prepared for tendering procurement are not independently reviewed, on a consistent basis, in order to ensure the terms agree with those of the successful bid.

Contracts are legal documents that bind the named parties to the stated terms for a specified period of time. The lack of a thorough terms review increases the risk that errors or omission of approved contract terms may go undetected resulting in the NSLC being bound to a contract that does not meet their needs. Examples of potential errors may include the following:

- a contract may be signed with a party other than the approved bidder;
- the contract price may be wrong, or
- the work may not be appropriately explained.

We recommend all draft contracts be reviewed and compared to the original tender package / successful bid to ensure accuracy and completeness. This should be completed by an individual independent of contract and tendering package creation.

4. Video Surveillance in the Warehouse

Security noted that there are blind spots within the video surveillance coverage of the warehouse.

The lack of complete video surveillance coverage may result in significant financial losses to the Corporation through theft of product or destruction of NSLC physical assets (e.g. inventory, equipment, etc).

We recommend that the presence of cameras in the warehouse be increased to minimize, and ideally eliminate, blind spots.

5. Personnel Job Descriptions

The process to ensure job descriptions are maintained and current is ineffective. To facilitate our documentation of the relevant systems, we obtained job descriptions for a variety of positions from the Human Resources department. These descriptions were provided to us with the representation that they were the most recently approved descriptions. Examples of out-of-date job descriptions were those for the positions of Vice President of Purchases and Distribution and the Accounting Supervisor.

In the case of the Vice President of Purchases and Distribution, the only job description documented is for the position of Director of Purchasing. This Director position, together with the responsibilities for the position, was changed to "Vice President of Purchases and Distribution" over a year ago.

In the case of the Accounting Supervisor, a current job description is available; however it has not been formally approved by the Human Resource department. This job description was one of several that were updated during the most recent performance evaluation process. Although the employees have knowledge of the up-dates, if they were to request a copy of their job description from the Human Resource department, only the approved position description would be available as the amended descriptions have not been finalized.

Job descriptions are a tool used during the hiring process to clarify the roles, responsibilities and qualifications for a given position. They aid employees in fulfilling the requirements of their job position and form a starting point for the performance evaluation process. Out-of-date job descriptions create the potential for an employee to perform unauthorized tasks and / or fewer tasks than is required or authorized for their position.

We understand that the Human Resource department is planning to review all job descriptions; however, this project has yet to be scheduled. In addition to this review, we recommend that management review the process for up-dating position descriptions by department and ensure the process is performed on a regular basis resulting in up-to-date master copies of the descriptions being maintained in the Human Resource department.

6. Inventory Receiving

A "blind" purchase order contains product descriptions but not the quantities ordered. The purpose of a blind receipt is to require inventory receiving staff to physically count the inventory received, ensuring that staff do not rely on stated quantities when receiving inventory shipments. Currently, Magstar cannot generate blind purchase orders; therefore, they are not used in the receiving process. In addition, during fiscal 2003, the Corporation approved a tendered proposal for a warehouse management system (WMS). The WMS is expected to employ the use of blind purchase orders in an electronic manner.

Errors/inaccurate receipts may occur in the inventory receipt process due to the absence of a blind purchase order process.

Until the blind purchase order process is fully implemented, we recommend that two receiving staff check the receipt of inventory into the warehouse, with one staff member counting the receipt and calling out the quantities while the other ticks off the product on both the printed purchase order and the Corporation's copy of the packing slip.

7. Purchase Order Tracking

The Magstar system allows the generation of a purchase order and its subsequent deletion, creating gaps in the numerical continuity.

Through our discussions with the Buyers, we noted two specific scenarios which allows a purchase order to be generated and subsequently deleted:

- If a purchase order is started but not completed and the user backs out of the purchase order process in Magstar that specific purchase order number is lost and cannot be recovered on the Magstar system.
- If a purchase order is completed on screen but not posted, then it can be deleted from Magstar and the purchase order number is lost and cannot be recovered.

Sequential purchase order numbering is a means of ensuring all purchase orders are accounted for. A gap in the numerical continuity raises doubt as to whether all transactions are recorded and authorized. For example, an employee with access to the purchase order module of Magstar can perform the following:

- Prepare a purchase order.
- Print the purchase order before posting.
- Subsequently delete the purchase order (the printed version of a purchase order appears the same regardless of being printed before or after posting).
- Fax the order to a supplier to have the product shipped to an alternate location.

Alternatively, using the same example, a buyer may inadvertently prepare and print a purchase order twice, delete one from the system (an "unused" PO) but forget to destroy the second paper copy, with both POs faxed to the vendor. While there may be controls in place to detect such an occurrence, preventive and early detection controls are imperative as a purchase order is viewed as a contract to purchase goods and the NSLC is in fact bound to pay for the goods whether or not the order was appropriately approved. Multiple instances may result in financial loss to the Corporation.

In addition, we noted that open (outstanding) purchase orders are not reviewed on a regular basis in order to mitigate the risk of unrecorded vendor accounts payable balances due to errors in receiving.

We recommend that the numerical continuity of purchase orders be tracked by an employee who does not have the ability to create purchase orders and that all gaps be identified and explained. This also includes tracking the "unused" purchase order numbers, as explained above. To facilitate this review, we recommend that the Corporation contact the Magstar vendor to request a log tracking feature on purchase orders such that the date prepared, time prepared and preparer (employee) are identified for all "unused" purchase order numbers.

We also recommend that a periodic review of open (outstanding) purchase orders be performed by an individual who does not have the ability to create purchase orders.

8. Independent Review of Reconciliations and Remittances

Bank reconciliations, the reconciliation of the accounts payable subledger to the general ledger control account, the HST remittance and the RRFB remittance are performed on a monthly basis; however, these reconciliations and remittances are only independently reviewed on a periodic basis.

The lack of a monthly independent review may result in omissions or errors not being detected and corrected within the Corporation's accounting records on a timely basis.

We recommend the reconciliations and remittances be independently reviewed monthly.

9. Vendor Master File Review

The vendor master file is not reviewed on a periodic basis to ensure that 1) each vendor is required and 2) to ensure the "child" vendors are all linked appropriately to "parent" vendor. Typically, the "parent" vendor refers to the Head Office location where payments are mailed and the "child" vendors refer to the various warehouse locations where shipments to the NSLC originate.

The lack of a formal periodic review process on the content of the vendor master file may result in excess vendor management effort due to the existence of duplicate or redundant (similar goods) vendors and resulting multiple payments to one vendor and / or payments being mailed to the wrong address.

We recommend that the vendor master file be reviewed periodically to identify redundant or duplicate vendors. A list of duplicate and / or redundant vendors should be maintained and the vendors removed when permitted by Magstar (after two years of inactivity). This list of vendors earmarked for deletion should be transmitted to appropriate staff to prevent the use of these vendors.

10. IT Disaster Recovery Plan

The Corporation does not have a current information technology disaster recovery plan.

A disaster has the potential for significantly interrupting normal business processing. Disasters are disruptions which cause the entire facility to be inoperative for a lengthy period of time. Sometimes disruption in service stems from system malfunctions, accidental file deletions or virus and network attacks.

Information Technology disaster recovery plans ensure that critical business processes can continue, or be resumed promptly, in the event of significant disruption to normal business operations. Normal business operations may be subsequently impaired without adequate recovery plans in the event of a disaster and could result in an inability to continue critical business processes.

We recognize, and strongly support, that the Corporation has identified updating the disaster recovery plan created in 1998 as an initiative within the information technology strategic plan for fiscal year 2004.

11. Identify and Assess IT Risks

A formal in-depth IT risk assessment process to identify, evaluate and manage the risks relating to information technology systems, on an ongoing basis, that support and enable the achievement of the Corporation's overall business objectives has yet to be developed.

The lack of a continuous risk assessment process prevents management from having sufficient information to make decisions with regards to the threats against the provision of continuous IT services and could impair the ability of the Corporation to achieve their overall business objectives.

As support for the recent Enterprise Risk Management (ERM) initiative, we recommend the Corporation establish and perform an ongoing detailed IT risk assessment. The framework should include a regular assessment of the relevant information risks to the achievement of the overall business objectives and form the basis of the decision making process on how the risks can be managed to an acceptable level. The framework should provide for the regular updating of assessments at the overall business and system specific levels. In addition, procedures should provide for monitoring of changes in systems processing activities to ensure risk exposures are identified and adjusted in a timely manner.

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Nova Scotia Liquor Corporation
Internal Control Action Plan
December 2003

SUMMARY OF FINDINGS

	Recommendation	Responsibility / Champion	Reporting Date	Comments
1	a. Management perform a regular formal review of inventory turnover.	VP – Merchandising & Marketing	March 31, 2004	1. Develop supply chain strategy which includes monitoring of inventory turns.
	b. Management and staff perform quarterly inventory counts and cycle counts.	Director – Distribution and VP – Operations & Development	March 31, 2004	2. Warehouse management system implementation in 1st quarter will provide cycle count functionality
2	On an interim basis (prior to reconfiguration of Magstar security levels:			
	a. perform regular independent reviews on a sample of purchases for reasonableness and appropriate approval.	Director – IT	December 31, 2003	Phase 1 - Implement recommended changes by internal audit
	b. Remove Manager – Information Systems signing authority on cheques.	Director - IT	March 31, 2004	Phase 2 - Complete Implementation
	c. Complete the review of Magstar security access levels and implement revised access privileges to appropriately segregate incompatible duties.	Corporate Secretary	November 30, 2003	Interim Audit Procedure until March 31, 2004 due to complexity of implementing system changes.
3	a. Revise and implement the use of a comprehensive tendering checklist.	Finance	December 31, 2003	Create tendering checklist with input from procurement section of public works.
	b. Formal approval of tenders prior to issuance of tender.	Finance	November 30, 2003	All tenders require signatures of divisional VP and VP-Finance/President
	c. Draft contracts be reviewed and compared to original tender package / successful bid to ensure accuracy and completeness.	Finance	January 31, 2004	Detailed analysis and process recommendation completed by VP-Finance by January 31, 2004
4	Increase coverage of video surveillance within warehouse.	Supervisor Loss Prevention & Insp.	January 31, 2004	Underway – to complete with Warehouse changes
5	Review the process for maintaining job descriptions to ensure the process is performed in a timely manner, ensuring that changes to job descriptions are reflected in up-to-date master copies of job descriptions in the Human Resource department.	VP – Human Resources	March 31, 2004	Not viewed as an internal control issue, but rather as an internal administrative procedure.
6	Re-implementing blind purchase orders through the Warehouse Management System project. Prior to the completion of the Warehouse Management System project, implement a two member team for receipt of goods (one counting / one checking count to stated quantity).	Director – Distribution	Completed	Warehouse Management System receiving module went live October 20, 2003

7	Request that the Magstar vendor provide a log tracking feature of all purchase orders, including deleted purchase orders. Perform an independent review on the reasons for all "unused" (deleted) purchase orders. Perform a periodic independent review of open (outstanding) purchase orders.	Director – IT VP - Finance	December 31, 2003 January 31, 2004	Review and make recommendation by December 31, 2003 with implementation target date January 31, 2004 Process to be established
8	Reconciliations and remittances be independently reviewed monthly.	VP – Finance	January 31, 2004	Process to be established
9	A periodic review be performed and a resulting list of duplicate and / or redundant vendors be maintained for removal (after two years of inactivity).	VP - Finance	January 31, 2004	Process to be established
10	Update the IT Disaster Recovery Plan.	Director – IT	January 31, 2004	Implementation by March 31, 2004
11	Establish an ongoing detailed IT risk assessment framework, including regular assessment of information risks and mitigation strategies.	Director – IT	March 31, 2004	Process underway

	Recommendation	Responsibility / Champion	Reporting Date	Comments
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	Coincident with the need to review other aspects of the NSLC and, in light of the recency of the new corporate governance model, Grant Thornton recommended and subsequently conducted a review of the corporate governance model and an enterprise risk management review.			